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November 13, 2006

Roger Weaver, Director
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210 North Lena Road
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**SUBJECT: FLEET MANAGEMENT DEPARTMENT INVENTORY FOR THE FISCAL
YEARS ENDED JUNE 30, 2005 AND JUNE 30, 2006**

Introductory Remarks

In accordance with Section V of the Auditor/Controller's Year-end Closing Manual, Fleet Management personnel conducted an inventory of their storerooms and fuel reserves. We observed the storerooms' parts inventory on June 22 and 23, 2005 and May 30 and June 27, 2006 and the fuel reserves inventory on June 27, 2005 and June 27, 2006, and have reported on the inventory valuation below.

Scope of the Audit

We audited the inventory procedures and controls in effect over the June 22, 23, and 27, 2005 and May 30 & June 22, 2006 Fleet Management Department's (Department) parts and fuel inventory. Our audit was made in accordance with generally accepted auditing standards and included such tests of the records and other audit procedures we considered necessary in the circumstances. The audit work performed during the audit would not necessarily disclose all material weaknesses in the system of internal controls.

Audit Results

In our opinion, computed using the average inventory cost method, the following is a fair valuation of Fleet Management's Warehouse – Garage inventory:

As of June 30, 2005
\$494,588

As of June 30, 2006
\$589,917

Furthermore, using the weighted average inventory cost method, the following is a fair valuation of Fleet Management's fuel inventory:

| | |
|----------------------------|----------------------------|
| <u>As of June 30, 2005</u> | <u>As of June 30, 2006</u> |
| \$368,038 | \$509,616 |

During our testing of inventory procedures and controls, we became aware of several matters that we consider opportunities for strengthening internal control and operating efficiency.

CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Finding 1: There is a lack of proper segregation of duties over the storerooms.

Good internal controls require a segregation of duties exist between the ordering, receiving, record keeping, and physical custody of parts on hand. It was noted in both the June 30, 2005 and 2006 audits that the Parts Supervisor oversees the physical inventory count and performs recounts as well as having the authority to order parts and record them into the inventory system. The supervisor's staff consists of a Storekeeper, a Store Specialist and Equipment Parts Specialists. Ideally, he segregates ordering to Storekeepers and receiving to Equipment Parts Specialists. Currently, his staff is down one Store Specialist and these duties have not been adequately segregated. All Parts personnel are currently able to order parts, receive them into inventory, and record them into the inventory system.

In the June 30, 2006 audit it was also noted that the Equipment Parts Specialist is the custodian of inventory in Storeroom 9 as well as the sole person responsible for conducting the physical count and recounts of inventory while also having the authority for inputting transfers and work orders into the inventory system.

Without a system of checks and balances, the Department is at a risk of thefts going undetected and inventory records being misstated.

Recommendation

Designate an individual outside of the Parts Department to oversee the physical count of inventory each month. Draft written procedures that designate position duties within the Department to ensure the proper segregation of duties is maintained, reorganizing or reassigning tasks as necessary.

Finding 1: There is a lack of proper segregation of duties over the storerooms.
-Continued

Department's Response

We agree with the findings of the ACR, a "non parts" employee will oversee and validate the monthly random physical count. Additionally, written procedures will be developed/implemented to ensure segregation of duties in the storerooms.

Finding 2: Inventory is not adequately safeguarded.

Good business practices require the enforcement and monitoring of internal controls over security measures in place to provide an adequate safeguard over inventory. It was noted in the June 30, 2006 audit that although there are locks on Storeroom 9, keys are not restricted and a record of who has the keys is not maintained. Internal controls over this area have not been enforced by management. The Department is at a risk of theft or shrinkage of inventory, which may result in a misstatement of the valuation of the inventory.

Recommendation

Secure all items of inventory and maintain a listing or log of who has keys to which areas of the storeroom. Restrict keys to the individual(s) with primary responsibility for the inventory.

Department's Response

We agree with the findings. The inventory has been secured and we have created a list/log of personnel that have keys to storerooms.

Finding 3: Internal controls over the physical fuel inventory could be improved.

Good internal controls require that assets be secured and monitored and written procedures be established to mitigate inadequate physical controls in order to safeguard department assets. It was noted in the June 30, 2005 audit that sites are kept locked and require passwords, but do not gauge the amount of fuel used. These are "honor" sites which rely on employee logs to determine the amount of gas used. Log sheets were not being filled out properly or completely. Fuel inventory at the manually gauged sites with incomplete logs is at greater risk of waste, theft, and abuse.

Recommendation

Ensure that written procedures have been established to properly monitor fuel usage when this cannot be automatically gauged. Draft or redistribute written

Finding 3: Internal controls over the physical fuel inventory could be improved.
- Continued

procedures to staff using the manually gauged sites. Also, place a copy of these procedures at the pumps to be readily available to staff at all times. Include in these procedures that log sheets be filled out completely and identify, at a minimum:

- Employee Name
- Employee ID
- Number of gallons pumped
- Vehicle number

Ensure that during weekly inventory logs are reviewed for completeness and fuel usage is monitored for reasonableness.

Department's Response

We agree with the findings. Fueling procedures and forms are waiting for final approval and will be distributed to the respective fuel sites/personnel. The fuel log has also been revised to include the vehicle number, gallons dispensed, odometer, date, employee number and employee signature. The log is being sent to Fleet Management weekly and reviewed for accuracy, completeness and reasonableness.

Finding 4: The methods for measurement of fuel inventory could be improved.

The County of San Bernardino Employee Safety and Health Manual, Code of Safe Practices requires that on all elevated locations, defined as "all surfaces over 7-1/2 feet above or below ground," staff be attached by lanyard or other approved fall protection device. This is communicated to staff through the year-end inventory instructions.

In the June 30, 2005 audit, it was noted that clock gauges were used to measure fuel inventory on those tanks that were too tall to safely take stick readings from. It was found during the reconciliation of the Baldy Mesa fuel site's year end inventory that the clock readings seem to fluctuate out of the normal range. Overages and underages of greater than 10% would occur within a two week period when compared to the calculated book balance. The clocks were deemed to be faulty, and it was recommended that stick readings be taken.

It was noted in the June 30, 2006 audit that the clocks were still deemed unreliable by the Department, but these measurements were supplemented with stick readings for all sites with clocks. However, during our observation it was noted that stick readings were

Finding 4: The methods for measurement of fuel inventory could be improved.
- Continued

taken from elevated locations without the use of fall protection devices. Violation of safety regulations puts staff at risk of accidents and injuries.

Recommendation

Continue to use stick readings to measure fuel inventory. If stick readings are used on surfaces over 7-1/2 feet above or below ground, ensure that staff taking the stick readings is aware of the requirement of the use of approved fall protection devices each time a stick reading is taken from an elevated location.

Department's Response

We agree with the findings. Fleet Management checks the fuel inventory reports weekly for discrepancies in the amount of through-put and the differences in the clock gauge readings to determine the accuracy of the clock gauges. When notable differences occur, corrective action is immediately taken. Stick readings will be taken bi-annually and results will be used to determine accuracy of clocks. Fleet Management will adhere to the County Code of Safe Practices in regard to the use of fall protection when working on the elevated above ground fuel tanks.

Finding 5: Internal controls over oil tanks could be improved.

Good internal controls require that assets be secured and monitored. During our June 30, 2006 audit we noted that oil tanks are not secure and are easily accessible to employees from other departments and that logs are not maintained to track the sale and usage of oil. At the time of the observation, there were no gauges or locks on these tanks, so it was difficult to track the oil. The Department is at risk of not detecting theft or shrinkage of inventory, thereby possibly misstating the valuation of their inventory.

Recommendations

Restrict access to oil tanks to those who have authorization to use them by ensuring that access to tanks is locked, and all usage and sale of oil has minimum documentation of the employee or customer name, employee or department ID, date, vehicle identification and amount of oil removed. Ensure that these logs are periodically reviewed and compared to inventory on hand for any discrepancies.

Department's Response

We agree with the findings. Locking devices have been placed on all oil drums, limiting access to only authorized personnel. Oil usage is logged at the tank and

Finding 5: Internal controls over oil tanks could be improved. - *Continued*

is tracked in the "Faster" work order system, which documents employee, customer name, department ID, date, vehicle number and amount of oil dispensed. Shop supervisors reconcile logs to work orders weekly to ensure dispensed oil is recorded. Physical inventory of oil tanks is included in the monthly "random" inventory.

Finding 6: The inventory system is not updated in a timely manner.

Good internal controls require that inventory records be maintained and updated in a timely manner. During the test count of Storeroom 9 for June 30, 2005, seven of the thirteen items sampled had actual counts that differed from the quantities listed on the inventory records. A lag in the input of work orders was also noted. In the June 30, 2006 observation it was noted that inventory locations noted on the inventory report have not all been updated to reflect the current inventory location in the storeroom, and oil transfers were not always updated into the inventory system in a timely manner. At the time of observation, the Department had acquired the entire Central Stores inventory and was in the process of updating all the correct inventory locations. The oil transfers were not being updated because without measuring gauges installed on oil tanks, it could not be determined how much oil had been transferred until it was used. The Department is at risk of not detecting theft or shrinkage of inventory. A lag in the input of work orders also contributes to a delay in the billing cycle. As a result, inventory records and the valuation of inventory are at risk of misstatement.

Recommendation

Ensure that transactions are input into the inventory system in a timely manner by assigning responsibility and providing procedures to those individuals in charge of this task. Ensure that management monitors the progress of the storeroom on an ongoing basis.

Department's Response

We agree with the findings. Physical inventory is conducted the day after monthly work orders are closed. The on-hand count discrepancies are reviewed by the superintendents and a complete physical count is conducted if the discrepancy is greater than 2%.

Finding 7: The internal inventory listing report does not properly extend.

Good internal controls require that reports properly extend across and total to provide a means of verifying the accuracy of calculations used to arrive at amounts. It was noted in both the June 30, 2005 and 2006 audits that the extended cost shown on the

Finding 7: The internal inventory listing report does not properly extend. -
Continued

inventory listing does not always equal the corresponding unit cost multiplied by the quantity on hand. For parts entered into the inventory system after implementation of the new system, FASTER, extended cost does not equate unit cost multiplied by quantity. This is because the report does not show sales tax computations, freight expenses or other miscellaneous expenses for new parts while older parts have these expenses included in the unit cost. A report that is not uniform throughout and that does not extend correctly raises doubts as to the accuracy of the entire report.

Recommendations

Modify the current inventory report to either include the sales tax rate, freight expenses and other miscellaneous expenses for all parts in the unit cost or add additional columns so that the additional costs become part of the extension.

Department's Response

We agree with the findings, the report has been modified to show unit cost, sales tax, freight expense and total cost.

Acknowledgments

We would like to express our appreciation for the cooperation and assistance provided to the auditor by the management and staff of the Fleet Management Department.

Respectfully submitted,

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Auditor/Controller-Recorder

By:

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